No. 20621

In the

United States Court of Appeals

For the Ninth Circuit

JOHN M. ROGERS and JOHN M. ROGERS, Executor of the Estate of Gladys B. Rogers, deceased,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Petitioners' Opening Brief

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SUBJECT INDEX

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I.

JURISDICTIONAL STATEMENT

Jurisdiction of the Tax Court in this proceeding is based on Internal Revenue Code of 1954, sections 7442 and 6213(a). Petitioners John M. Rogers and Gladys B. Rogers during the years in question, 1957 and 1958, resided at 2183 Danville Highway, Walnut Creek, California. Petitioner John M. Rogers currently resides at that address. Petitioners' joint return for 1958 was filed with the Director of Internal Revenue at San Francisco, California. The notice of deficiency for that year was mailed to petitioners on June 28, 1963, and petitioners' Petition was filed in the Tax

Court on August 19, 1963, within 90 days of the mailing of the notice of deficiency.

Jurisdiction of this Court is based upon Internal Revenue Code of 1954, section 7482, the appeal being from a decision of the Tax Court entered on July 26, 1965. The Petition for Review was filed on October 18, 1965, within three months after the decision was rendered, as required by Internal Revenue Code of 1954, section 7483. The Petition for Review was in the form prescribed by Rule 29, Rules of the United States Court of Appeals for the Ninth Circuit and a copy of the Petition for Review, together with a Notice of Filing Petition for Review, was served on the respondent, as required by said Rule 29. The petitioners filed their joint return for 1958 with the office of the Director of Internal Revenue at San Francisco, California, which office is located within the jurisdiction of the United States Court of Appeals for the Ninth Circuit. Venue in this Court is proper under Internal Revenue Code of 1954, section 7482(b).

II.

STATEMENT OF THE CASE

The instant case arises from certain transactions occurring during the years 1957 and 1958 whereby petitioners exchanged certain real property located at 571 Market Street, San Francisco, California, owned and held by them for investment, for like investment property, being an office building hereinafter referred to as the "Sharon Building." Petitioners reported the transaction in question on their joint Federal Income Tax Return for the calendar year 1958 as a tax-free exchange of like property under the provisions of section 1031(a) of the Internal Revenue Code of 1954.*

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*Section 1031 provides as follows:

(a) *Nonrecognition of Gain or loss from Exchanges Solely in Kind.*—No gain or loss shall be recognized if property held for productive use in trade or business or for investment (not including

Respondent characterized this exchange as a sale of 571 Market Street, followed by a purchase of the Sharon Building, and determined a deficiency in tax on the ground that petitioners had sold 571 Market Street and realized long-term capital gain as a result thereof. The Tax Court, Atkins, J., upheld respondent's position.

A. Statement of Facts

The following uncontradicted facts are contained in the Stipulation of Facts entered into between the parties on June 17, 1964 (C.T. 18-27), the Findings of Fact of the Tax Court herein (C.T. 145-156), and the oral testimony and documentary evidence presented at trial.*

1. Petitioners before the Tax Court were John M. Rogers and his wife, Gladys B. Rogers, now deceased. John M. Rogers, Executor of the Estate of Gladys B. Rogers, has been substituted as a proper party in place of said Gladys B. Rogers. As used herein, the term "petitioners" will refer jointly to John M. Rogers and Gladys B. Rogers.

2. Petitioners resided at Walnut Creek, California. They filed joint Federal income tax returns on the cash method

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stock in trade or other property held primarily for sale, nor stocks, bonds, notes, choses in action, certificates or trust or beneficial interest, or other securities or evidences of indebtedness or interest) is exchanged solely for property of a like kind to be held either for productive use in trade or business or for investment.

(b) *Gain From Exchanges Not Solely in Kind.* If an exchange would be within the provisions of subsection (a) * * * if it were not for the fact that the property received in exchange consists not only of property permitted by such provisions to be received without the recognition of gain, but also of other property or money, then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property.

*References to the Clerk's Transcript (Volumes A and B of the Record) will be cited "C.T. ....," and references to the Reporter's Transcript (Volume II of the Record) will be cited "R.T. ....."

for the taxable years 1958, 1959 and 1960 with the District Director of Internal Revenue, San Francisco, California. (C.T. 145; Exh. 1-A, 2-B, 3-C, C.T. 28, 49, 62).

3. Late in 1955 petitioner John M. Rogers retired from his position as an executive of a large international engineering construction organization and thereafter was concerned with securing investment income. In April 1956, petitioners acquired for investment an office building situated at 571 Market Street, San Francisco, California, and thereafter held such property for the income derived from rents and profits. Coldwell, Banker & Company, a San Francisco real estate firm, performed for a fee the various duties associated with the management of the building. (C.T. 145-146).

4. The Standard Oil Company of California (hereinafter referred to as Standard Oil) desired to acquire five adjoining properties, including 571 Market Street, as the site for a proposed new office building, and prior to August 22, 1957, commissioned Buckbee Thorne & Co., a San Francisco real estate firm (hereinafter referred to as Buckbee Thorne) to negotiate for the purchase of such five properties on behalf of Standard Oil as undisclosed principal. Since Standard Oil wished to remain an undisclosed principal until all five properties had been assembled, Buckbee Thorne, with the authorization of Standard Oil, named California Pacific Title Insurance Company (hereinafter referred to as Cal Pac) to acquire title for its principal. (C.T. 146).

5. During August 1957, petitioners were approached by a representative of Buckbee Thorne who desired to obtain an option to purchase 571 Market Street. They advised such representative that they would sell for a price of $750,000, plus the real estate commission, and on August

13, 1957, an escrow account (numbered 462011) was opened at Cal Pac under the name "Buckbee Thorne—Rogers." (C.T. 146).

6. On August 22, 1957, petitioners granted to Cal Pac an option to purchase 571 Market Street. The option agreement provides in pertinent part as follows:

> For and in consideration of the sum of SEVEN THOUSAND SEVEN HUNDRED AND TWELVE AND 50/100 ($7,712.50) Dollars to seller in hand paid, the receipt of which is hereby acknowledged by said seller, to apply on the purchase price, the undersigned JOHN M. ROGERS and GLADYS B. ROGERS herein designated as the seller, hereby grants the right and option to purchase and agrees to sell to CALIFORNIA PACIFIC TITLE INSURANCE COMPANY herein designated as the purchaser, or its assigns, at any time within 120 days from the date hereof, the following described property in the City and County of San Francisco, State of California, to wit:
>
> [here follows description of 571 Market Street]
>
> For the purchase price of SEVEN HUNDRED SEVENTY ONE THOUSAND TWO HUNDRED FIFTY AND 00/100 ($771,250.00) Dollars lawful money of the United States of America, payable as follows: CASH
>
> * * * * * * *
>
> If said purchaser elects to purchase said property at the price and on the terms herein set forth, and within the time specified, the said purchaser shall give said seller due notice in writing and shall pay an additional sum of $69,412.50 for account of said seller to Buckbee Thorne & Co. * * * said sum to apply on the purchase price, whereupon thirty (30) days after the exercising of this option shall be allowed said purchaser to examine title to said property and report any valid objection thereto, if any, to said seller. If no such objection to title is reported, the balance of the purchase price shall be paid by said purchaser at or

before the expiration of said time and said seller shall thereupon deliver a properly executed and acknowledged grant deed to said property. (C.T. 146-147; Exh. 4-D, C.T. 75).

7. By letter dated August 30, 1957, Buckbee Thorne transmitted to Cal Pac the option granted by petitioners to Cal Pac, as well as options for the other properties Standard Oil was seeking to acquire. (C.T. 147; Exh. 6-F, C.T. 78).

8. Petitioners then advised Coldwell, Banker & Co., as managers of their property, that they had granted an option for the purchase of 571 Market Street. (C.T. 147).

9. In mid-September 1957, petitioners were approached by Coldwell, Banker & Co., acting as agents for the owners (hereinafter called the "Sharons") of an office building known as the Sharon Building, with the suggestion that the Sharon Building might be purchased for $1,200,000, and that the proceeds from the sale of 571 Market Street might be used for such purpose. Prior to that time, petitioners were not aware that the Sharon Building was for sale. They advised Coldwell, Banker & Co. at that time that they were not interested in buying another piece of property, but rather that they intended to invest the proceeds from the sale of 571 Market Street in high grade stock. Coldwell, Banker & Co. then suggested that if they did not wish to purchase the Sharon Building, an advantageous exchange of 571 Market Street for the Sharon Building could be made and that petitioners would receive a return on their investment which would be substantial and comparable to that which they were then receiving. Petitioners, after consulting with counsel, proposed an exchange in which the Sharon Building would be valued at $1,050,000 and 571 Market Street would be valued at its then option

price of $771,250. This proposal was rejected, but the Sharons countered with an offer to value the Sharon Building at $1,150,000 for purposes of such an exchange, to which proposal petitioners agreed. (C.T. 147-148; R.T. 25-27).

10. Petitioners executed a document prepared by Coldwell, Banker & Co. entitled "Agreement to Exchange", dated December 2, 1957. Therein it was recited that they agreed to exchange 571 Market Street for the Sharon Building. It was further provided therein that 571 Market Street should be transferred subject to existing leases and "subject to existing option to sell, which obligation is to be assumed by the owners" of the Sharon Building. It was therein further provided that coincident with the exchange of deeds to the two properties, petitioners agreed to pay the owners of the Sharon Building $400,000 in cash. (C.T. 148-149; R.T. 29; Exh. 39, C.T. 142).

11. Petitioners at all times considered themselves bound by the Agreement to Exchange and were at all times prepared to exchange with the Sharons. (R.T. 50, 51).

12. On December 6, 1957, petitioners left the Agreement, as executed by them, with Coldwell, Banker & Co. On the same date an escrow account (numbered 463529) was opened at Cal Pac under the name "Sharon—Coldwell, Banker & Co." (C.T. 149; R.T. 29).

13. On December 9, 1957, petitioner John M. Rogers sent a letter to Cal Pac advising that he had entered into an agreement with the Sharons to exchange 571 Market Street, subject to the outstanding option, for the Sharon Building. (C.T. 149; Exh. 8-H, C.T. 80).

14. On December 9, 1957, Cal Pac issued a preliminary title report concerning the Sharon Building and delivered it to petitioners. (C.T. 149; Exh. 9-I, C.T. 82).

15. On December 16, 1957, petitioner John M. Rogers delivered to Cal Pac his check for $7,712.50, which amount equalled the consideration previously paid to him and his wife for the option granted by them on August 22, 1957. The receipt given by Cal Pac for such amount stated that such sum was to be applied on an exchange proration statement to be supplied by Coldwell, Banker & Co. (C.T. 150; Exh. 11-K, C.T. 85).

16. On December 16, 1957, petitioners delivered to Cal Pac a deed conveying 571 Market Street to Cal Pac. At the same time petitioners gave written escrow instructions to Cal Pac "to deliver said deed to the order of Hurford C. Sharon, et al.," at such time as Cal Pac had vested title to the Sharon Building in petitioners, and had carried out petitioners' further instructions not pertinent hereto. (C.T. 150; Exh. 12-L, 13-M, C.T. 86, 87).

17. On December 16, 1957, Buckbee Thorne notified Cal Pac that thereafter Standard Oil would issue instructions to Cal Pac regarding the options. (C.T. 149; Exh. 10-J, C.T. 84).

18. On December 18, 1957, Standard Oil delivered a letter of escrow instructions authorizing and directing Cal Pac to record on December 18, 1957, the five options (including the option on 571 Market Street), to exercise such options on December 19, 1957, by sending notices to the respective property owners in care of Buckbee Thorne, to take title to the properties in its (Cal Pac's) name, and then convey the five parcels of property to Standard Oil in one grant deed. Therein Standard Oil stated that it would at the same time deliver to Buckbee Thorne for the account of the respective owners the amounts required to be paid upon the exercise of the options and that it would issue to Cal Pac a check for $2,344,537.50 to cover the remaining purchase price of all the five properties. (C.T. 150-151; Exh. 14-N, C.T. 89).

19. On December 19, 1957, Hurford C. Sharon, one of the twelve owners of the Sharon building, executed a grant deed conveying his interest in the Sharon Building to petitioners. (Exh. 20-T, C.T. 102). The remaining deeds to the Sharon Building were executed between December 19, 1957 and January 8, 1958. (C.T. 152).

20. On December 19, 1957, Cal Pac sent a letter, dated December 13, 1957, to Buckbee Thorne, giving notice of the exercise of the option on 571 Market Street. At the same time Cal Pac gave its check in the amount of $69,412.50 to Buckbee Thorne for the account of petitioners, and furnished Buckbee Thorne a copy of the previously mentioned letter of December 9, 1957, sent by petitioners to Cal Pac with regard to petitioners' execution of the Agreement to Exchange. On the same date, Standard Oil delivered to Cal Pac its check for $2,344,537.50 (C.T. 151; Exh. 15-O, 16-P, C.T. 97, 98).

21. On December 20, 1957, petitioners learned for the first time that the outstanding option was being exercised. (R.T. 35, 39). On that date, Buckbee Thorne notified petitioners by telephone that the option had been exercised and that it had received from Cal Pac its check for $69,412.50. On the same date, Buckbee Thorne addressed a letter to petitioners containing the same information and stating that Cal Pac had requested that the check be returned to it to be held by it in connection with an exchange of 571 Market Street for the Sharon Building. Therein Buckbee Thorne requested petitioners' approval to pay over the $69,412.50 to Cal Pac for such purpose. On a copy of such letter, petitioners on December 23, 1957, acknowledged receipt of notice of the exercise of the option and approved the payment of the $69,412.50 to Cal Pac. Accordingly, on the same day, Buckbee Thorne endorsed the check and returned it to Cal Pac (C.T. 151-152; Exh. 17-Q, 18-R, 19-S, C.T. 99, 100, 101).

22. On January 16, 1958, the deeds to the Sharon Building from the various owners thereof were delivered to Cal Pac. These deeds were enclosed in a letter of escrow instructions by Hurford C. Sharon, acting as agent for the Sharons, wherein Cal Pac was authorized to deliver the deeds to petitioners when Cal Pac had received $1,150,000 for the account of the Sharons. Such letter also contained the following:

> It is understood that $400,000.00 of such sum is to be received by you from the Rogers and $750,000.00 is to be received by you from a purchaser of [description of 571 Market Street], which property is hereinafter referred to as the "Exchange Property." It is understood that Rogers will convey to you on behalf of the Owners [Sharon interests], the Exchange Property, in addition to the payment of said sum of $400,000.00. You are hereby authorized to execute a deed of the Exchange Property on behalf of the owners [Sharons] conveying said property to Standard Oil Company of California, the present holder of an option to purchase the Exchange Property, or its order, and you are further authorized to deliver said deed to said grantee when you hold said sum of $750,000.00 heretofore mentioned for the account of the Owners [Sharons]. (C.T. 152; Exh. 20-T, 21-U, C.T. 102, 104).

23. On the same date the above instructions were amended to authorize the delivery of the deeds to petitioners upon the receipt by Cal Pac for the account of the Sharons of $1,118,750 ($368,750 from petitioners, and $750,000 from Standard Oil), instead of $1,150,000, the difference of $31,250 representing commission of Coldwell, Banker & Co. for arranging the transaction. On the same date Hurford C. Sharon issued supplemental instructions to Cal Pac to release the sum of $21,250 out of funds deposited by Standard Oil to satisfy the demand of Buckbee

Thorne, and also to prorate rent and insurance credited on the Market Street property and pay it to the ultimate purchaser, Standard Oil. (C.T. 153; Exh. 22-V, 23-W, C.T. 109, 111).

24. On January 16, 1958, Cal Pac recorded the deeds transferring the Sharon Building to petitioners, and petitioners' deed conveying 571 Market Street to Cal Pac. On the same date, petitioners notified the tenant of 571 Market Street to pay all future rentals to Cal Pac. (C.T. 153; Exh. 33-GG, C.T. 134).

25. On January 20, 1958, Cal Pac sent to the manager of the office buildings department of Standard Oil a letter in which it was stated that on January 16, 1958, it had recorded, for the account of Standard Oil, the deed from petitioners to Cal Pac covering 571 Market Street. (C.T. 153-154; Exh. 34-HH, C.T. 135).

26. On January 29, 1958, Cal Pac sent a letter to Coldwell, Banker & Co. stating that the Sharon Building was acquired by petitioners "in consideration of the sum of $400,000.00 and the exchange of Market Street property, which was sold in the same transaction, for a consideration of $750,000.00." (C.T. 154; Exh. 35-II, C.T. 138).

27. On January 31, 1958, Cal Pac executed one grant deed conveying to Standard Oil the five parcels of property, including 571 Market Street, and such deed was recorded on that date. On the same date, Cal Pac assigned the lease of 571 Market Street to Standard Oil, and notified the tenant to pay all future rentals to Standard Oil. (C.T. 154; Exh. 36-JJ, C.T. 139).

28. Petitioners had collected the rental on 571 Market Street for the full month of January 1958 in the amount of $4,583.33. Of this amount they retained $2,291.67, representing the amount allocable to the period from January 1

to January 16. The remainder was not received by the Sharon interests, but was paid to Standard Oil. (C.T. 154).

29. After petitioners acquired the Sharon Building, they held it for the income derived from rents and profits. (C.T. 154).

30. On their Federal income tax return for the taxable year 1958, petitioners reported the above transaction as an exchange involving unrecognized gain.

In the notice of deficiency respondent determined that gain should be recognized, stating:

> It is determined that you realized a long-term capital gain in the amount of $439,265.85 resulting from the sale of the real estate known as 571 Market Street, San Francisco, California. Such gain is taken into account to the extent of 50%, or $219,632.92, in computing taxable income. The gain is computed as follows:
>
> | | |
> |---|---|
> | Sales price | $771,250.00 |
> | Expense of sale | 22,100.65 |
> | Net | $749,149.35 |
> | Basis per return | 309,883.50 |
> | Gain on sale | $439,265.85 |
>
> (C.T. 155-156).

31. The Tax Court, Atkins, J., found that petitioners sold 571 Market Street to Standard Oil and purchased the Sharon Building with the proceeds thereof, and that by reason of such sale and purchase, petitioners did not effect an exchange within the meaning of Internal Revenue Code, section 1031(a). (C.T. 157-164).

B. Questions Presented

The following questions are presented for determination by this Court:

1. Did petitioners effect a direct exchange of 571 Market Street for the Sharon Building, notwithstanding the exist-

ence and the exercise of the option granted by petitioners to Cal Pac to purchase 571 Market Street?

2. Assuming that petitioners sold 571 Market Street to Standard Oil and simultaneously purchased the Sharon Building with the intent to effect an exchange, does such transaction qualify as an exchange under section 1031(a) of the Internal Revenue Code?

III.

SPECIFICATION OF ERRORS

A. The Tax Court erred in finding that petitioners did not exchange 571 Market Street for the Sharon Building. (C.T. 161-162).

B. The Tax Court erred in finding that petitioners sold 571 Market Street to Standard Oil and purchased the Sharon Building from the proceeds thereof. (C.T. 162-163).

C. The Tax Court erred in determining that the instant transaction failed to qualify as an exchange under section 1031(a) of the Internal Revenue Code. (C.T. 164).

IV.

ARGUMENT

A. Introduction

From the Statement of Facts set forth at Part IIA hereof, the following conclusions are apparent:

1) Petitioners *intended* to effect an exchange with the Sharons;

2) Likewise, the Sharons *intended* to effect such an exchange;

3) The escrow transactions and instructions took the *form* of an exchange;

4) Petitioners never *owned, used or enjoyed* the monies deposited in escrow by Standard Oil (the "proceeds" of the alleged "sale"); and

5) The *substance* of these transactions was that in net effect an exchange had been consummated.

Thus, whether these transactions be examined from the standpoint of either form, substance, intent of the parties, net effect, or underlying statutory purpose to tax only gain in the popular or economic sense, it is apparent that the Tax Court has reached an incorrect and unjust decision, based upon faulty premises. An examination of the premises upon which this decision was based readily supports this conclusion.

In brief, the Tax Court based its decision upon these two premises:

1) Petitioners did not exchange 571 Market Street for the Sharon Building; instead, petitioners sold 571 Market Street to Standard Oil and used the proceeds therefrom to purchase the Sharon Building. (C.T. 161-163).

2) Internal Revenue Code, section 1031(a) applies only to "direct exchange" situations and not to the sale and simultaneous purchase of like property. (C.T. 158).

Petitioners submit that both of these premises are erroneous and that such error affords petitioners two independent grounds for reversal of the Tax Court's decision herein.

B. Petitioners Directly Exchanged 571 Market Street for the Sharon Building

Petitioners submit that the uncontroverted facts in this case prove that petitioners directly exchanged 571 Market Street for the Sharon Building.*

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*Further reference to the facts in this case will be made by reference to specific numbered paragraphs in petitioners' Statement of Facts, *supra*, e.g. "S.F. .....".

First of all, it is clear that both petitioners and the Sharons *intended* to effect such an exchange. The negotiations between petitioners and the Sharons which resulted in petitioners' execution of the Agreement to Exchange were conducted for the express purpose of arranging for the exchange of petitioners' property for the Sharon Building. (S.F. 9).

The Agreement itself establishes a clear intent to effect such an exchange. The Agreement was prepared by Coldwell Banker & Co., acting as agent for the Sharons, and reduced to writing the Sharons' offer to exchange their property for petitioners' property on the basis of a valuation of $1,150,000 for the Sharon Building. (S.F. 9, 10).

This Agreement expressly provided for such an exchange (S.F. 10), and petitioners at all times thereafter considered themselves fully bound by the Agreement and were fully prepared to consummate the exchange. (S.F. 11).

At the times when these negotiations took place and petitioners executed the Agreement, the outstanding option to purchase (which was to expire on December 20, 1957) had not been exercised, and petitioners had no knowledge if or when it would be exercised. (S.F. 21). Under California law, an unexercised option to purchase real property neither constitutes a contract of purchase and sale nor does it give the option holder any interest in the property itself (50 Cal. Jur.2d, *Vendor and Purchaser,* sec. 164 at pp. 211-212 [1959]). Therefore, at the time when petitioners executed the Agreement to Exchange with the Sharons, they had every right to do so, the outstanding option was no impediment thereto, and there was no reason for them to believe that the exchange would not be consummated.

Aside from an intent to exchange, both petitioners and the Sharons took immediate steps to effect an exchange. On

December 6, 1957, the same day petitioners executed and returned to Coldwell Banker the Agreement to Exchange, an escrow was opened with respect to the Sharon exchange, and on December 9, petitioners notified Cal Pac, the option holder, of the forthcoming exchange. (S.F. 12, 13). Thereafter, on December 16, petitioners returned the $7,712.50 option binder to Cal Pac, as escrow holder in the exchange escrow, to be applied to the exchange, and Cal Pac acknowledged that such sum would be so applied. (S.F. 15). On the same day, petitioners delivered to Cal Pac as escrow holder the deed to 571 Market Street, along with escrow instructions which, in pertinent part, authorized delivery of the deed only *to the order of the Sharons,* upon vesting title to the Sharon Building in petitioners. (S.F. 16). Shortly thereafter, on December 19, the Sharons executed the first of the deeds conveying the Sharon Building to petitioners. (S.F. 19). All these events occurred before petitioners learned that Standard Oil had exercised its option to purchase petitioners' property. (S.F. 21).

Both the intent and effect of petitioners' escrow instructions are clear: Petitioners conditioned the transfer of 571 Market Street *to the Sharons* upon vesting title to the Sharon Building in petitioners. Obviously, had petitioners intended to effect a sale, in the event the outstanding option was exercised prior to the consummation of the exchange, petitioners' instructions would have provided in the alternative for the transfer of 571 Market Street to *Cal Pac* on behalf of its undisclosed principal, *Standard Oil,* conditioned upon receipt in escrow of the unpaid purchase price.

In fact, petitioners consistently treated the transaction as an exchange, even after learning that the option had been exercised. Instead of amending their previous escrow instructions to include provision for a sale to Standard Oil

and a subsequent purchase of the Sharon Building from the proceeds therefrom, petitioners, on December 23, 1957, simply acknowledged receipt of the notice of exercise of option and confirmed Buckbee Thorne's suggestion that the $69,412.50 option payment made by Standard Oil be returned to Cal Pac to be held by it in connection with the exchange of property and pending consummation of the exchange. (S.F. 21). Title to such payment remained at all times with Standard Oil, until transferred to the Sharons. 18 Cal.Jur.2d, *Escrows,* sec. 11, at pp. 319-320 (1954).

Moreover, the Sharons' escrow instructions likewise contemplated a direct exchange with petitioners and a simultaneous sale by the Sharons to Standard Oil.

The Sharons' instructions authorized Cal Pac, as their escrow agent, to deliver the deeds to the Sharon Building to petitioners and to convey 571 Market Street to Standard Oil *on behalf of the Sharons,* when Cal Pac received $1,150,000 for the account of the Sharons, comprised of $400,000 from petitioners and $750,000 from Standard Oil. (S.F. 22). Thus the intent and effect of the Sharons' instructions likewise are clear: The Sharons simply combined a two-step transaction into one set of escrow instructions to provide for the exchange of the Sharon Building for 571 Market Street and $400,000, and the sale of 571 Market Street by them to Standard Oil for $750,000. Had the Sharons intended merely to effect a *sale* of the Sharon Building to petitioners, these instructions would have simply conditioned the transfer to petitioners of deeds to the Sharon Building upon receipt of the purchase price thereof *from petitioners,* without reference to Standard Oil or the 571 Market Street property.

Thus, both the petitioners and the Sharons, in performance of their original Agreement to Exchange, instructed

Cal Pac, their common escrow agent, to effect a mutual exchange of property, and this was precisely what was done. On January 16, 1958, having received escrow instructions from both parties which provided for an exchange of their respective properties, Cal Pac recorded the deeds transferring the Sharon Building to petitioners and the deed conveying 571 Market Street to Cal Pac. (S.F. 24).

From Standard Oil's viewpoint, its escrow instructions simply authorized Cal Pac to record its various options to purchase, to exercise the same, and to deliver the balance of the purchase prices for the various parcels to the "respective sellers" upon recording deeds to such properties in Standard Oil's name. (S.F. 18). These instructions obviously did not preclude the consummation of the exchange between petitioners and the Sharons. Cal Pac was given full authority from the Sharons to deliver title to 571 Market Street to Standard Oil, upon receipt of the purchase price therefor. Thus Standard Oil's instructions were fully consistent with those of the Sharons and petitioners. In any event, any activities or statements of Standard Oil or its agent Cal Pac in derogation of the agreement between petitioners and the Sharons for an exchange of their property would have had no relevance to the instant question. For as we shall see, neither Standard Oil nor Cal Pac had at any time any rights with respect to 571 Market Street which could have prevented the consummation of the exchange.

The Tax Court's premise that petitioners sold their property to Standard Oil and purchased the Sharon Building from the proceeds of that sale is therefore wholly contrary to the express intention of the parties and utterly ignores what was actually accomplished in the escrow transactions described above. In order to avoid the effect of these escrow transactions, which had every characteristic of an actual,

direct exchange, the court rejected this evidence as constituting "mere formal matters which do not reflect the substance of the transaction." (C.T. 162). The court thus substituted its view of the "substance" of the transaction for the proof afforded by the evidence. This approach might be understandable except for the fact that the evidence also conclusively proved that the substance of the transaction was an exchange. The court dismissed as controlling the fact that the parties intended to effect an exchange and that in substance and net effect an exchange had been effected, on the sole ground that its decision "must be governed by what was actually done, rather than by what might have been done." (C.T. 164). Petitioners hasten to point out that "what might have been done" could only have constituted a mere change in the *form* of the transaction, *e.g.*, by arranging for Standard Oil to acquire the Sharon Building and thereupon to exchange it for petitioners' property, as was done in the *Alderson, Coastal Terminals,* and *Mercantile Trust* cases discussed *infra*. The court's decision thus ignores both form and substance and is, we submit, contrary to the evidence in this case and the law applicable thereto.

Apparently, the court's premise that petitioners sold 571 Market Street to Standard Oil was based solely upon the fact that Standard Oil exercised its option to purchase before the exchange with the Sharons could be fully consummated. (C.T. 161-162). The court reasoned that, since Standard Oil exercised its option, Standard Oil became entitled to receive a deed to the property and that it somehow, at some unspecified time, acquired this property from petitioners before petitioners acquired deeds to the Sharon Building. (C.T. 161-162). The short answer to the court's conclusion is simply this: While Standard Oil may have

had a contractual right to receive 571 Market Street upon exercising its option and upon complying with the conditions thereof, the existence of this right did not of itself constitute a sale, and likewise did not in any manner prevent petitioners from transferring 571 Market Street to the Sharons.

In California the law in this regard is quite clear:

> *Transfer or Assignment by Vendor.*—As long as legal title remains in the vendor it may be conveyed by him, and a vendor under an executory contract for the sale of land may sell to a third person the land covered by the contract, at the same time assigning the contract, or he may merely convey the land subject to the prior rights of the purchaser under the contract. 50 Cal.Jur.2d, *Vendor and Purchaser,* sec. 133, at p. 172 (1959).

See also *Bone v. Dwyer,* 89 Cal. App. 535, 541, 265 Pac. 292 (1928); *Day v. Cohn,* 65 Cal. 508, 509-510, 4 Pac. 511 (1884); Ogden, California Real Property Law, sec. 9.8(1), at p. 349 (1956).

Thus, the owner may effect a valid transfer of the property to a third person, and such transfer does not constitute a breach of the original contract if the third person agrees to assume the owner's obligations under that contract:

> *Conveyance to Third Party Before Time for Performance.*—A vendor who has title at the time a contract for the purchase and sale of realty is entered into may divest himself of the ownership of the land during the executory period of the contract. Such a conveyance of the property to a third person before the time for performance is not a breach or ground for rescission, if it is made under such circumstances as to protect the rights of the purchaser. 50 Cal. Jur. 2d, *Vendor and Purchaser,* sec. 306, at pp. 394-395 (1959).

See also, *Heden v. Point Reyes Land Co.*, 185 Cal. 121, 125, 196 Pac. 44 (1921).

Obviously, Standard Oil and its agent Cal Pac recognized these principles, for they fully acquiesced in petitioners' exchange. Even before the time that the notice of exercise of the option was given, Cal Pac as agent for Standard Oil knew that petitioners had entered into an agreement to exchange the subject property with the Sharons and that petitioners had deposited into escrow a deed to such property to the order of the Sharons in furtherance of this agreement. (S.F. 13, 15, 16). Such knowledge clearly was imputed to Standard Oil as principal. 2 Cal. Jur. 2d, *Agency,* sec. 160, at pp. 855-856 (1952); 18 Cal. Jur. 2d, *Escrows,* sec. 16, at pp. 328-330 (1954).

Furthermore, Cal Pac as agent for Standard Oil never looked to petitioners for performance of the option agreement, but instead acknowledged the existence of the Agreement to Exchange, accepted from Buckbee Thorne the $69,412.50 option payment to be held in escrow pending the exchange, and ultimately recognized that in fact petitioners acquired the Sharon Building in exchange for 571 Market Street, and that 571 Market Street "was sold in the same transaction" to Standard Oil. (S.F. 20, 21, 26).

Thus it is evident that Standard Oil fully accommodated petitioners' intent to effect an exchange with the Sharons, notwithstanding its contractual rights with respect to 571 Market Street. Moreover, as we have previously pointed out, such accommodation was in recognition of the well-established legal principle that the mere existence of a contract of purchase and sale does not effect the validity of a transfer of the property to a third person taking the property subject to that contract.

On the basis of the foregoing authorities and analysis, the Tax Court's holding that petitioners sold their property to Standard Oil is bewildering. The Tax Court admittedly was unable to state *when* such a sale could have occurred. (C.T. 162, note 7). The reason for its difficulty in this regard is simply that under both the law and the facts, no such sale ever occurred.

A "sale" occurs for tax purposes when the purchase price is paid to the vendor and a deed to the property is transferred to the purchaser. *E.g., Newaygo Portland Cement Co.,* 27 B.T.A. 1097, 1104-1105 (1933), *acq.,* XII-1 Cum. Bull. 9, *aff'd,* 77 F.2d 536 (D.C. Cir. 1935); *Lucas v. North Texas Lumber Co.,* 281 U.S. 11 (1930). The evidence is uncontradicted that until January 16, 1958, no deed to 571 Market Street was delivered to anyone, either by petitioners or by Cal Pac. Cal Pac could not and did not deliver petitioners' deed to the order of the Sharons until January 16, *after* Cal Pac had been authorized by the Sharons to execute and deliver a deed on behalf of the Sharons to Standard Oil or its order. A deed to 571 Market Street was thereafter delivered, in accordance with the escrow instructions of the Sharons and Standard Oil, to Standard Oil on January 31, 1958. (S.F. 16, 18, 22, 24, 26, 27).

Contrary to the Tax Court's sentiment that these were mere "formal matters," the law is clear that an escrow holder has no authority to deliver a deed in conflict with the parties' escrow instructions, and a deed delivered contrary to such instructions is void. 18 Cal. Jur. 2d, *Escrows,* sec. 37, at pp. 369-371 (1954); *Los Angeles High School Dist. v. Quinn,* 195 Cal. 377, 383, 234 Pac. 313 (1925). Petitioners gave Cal Pac no authority other than to deliver a deed "to the order of Hurford C. Sharon et al. . . ." (S.F. 16).

It is clear that both the facts and the law applicable thereto compel the conclusion that Standard Oil's contractual rights with respect to 571 Market Street did not prevent the consummation of an exchange with the Sharons, and consequently, that no sale between petitioners and Standard Oil ever occurred.

The case which controls the disposition of the instant matter is *Alderson v. Commissioner*, 317 F.2d 790 (9th Cir. 1963), reversing 38 T.C. 215. In *Alderson,* taxpayers originally entered into an agreement with Alloy for the purchase and sale of taxpayers' Buena Park property. Thereafter, taxpayers decided to effect an exchange of such property for Salinas property owned by a third party. Alloy agreed to taxpayers' plan whereby Alloy would acquire title to the Salinas property and immediately reconvey it to taxpayers in exchange for taxpayers' Buena Park property.

Thereafter, taxpayers entered into a contract with the owners of the Salinas property whereby taxpayers agreed to purchase such property for cash. Taxpayers' escrow instructions requested the escrow holder to take title to the Salinas property in its own name, to execute and record a deed to Alloy, and thereupon to immediately reconvey the property to taxpayers.

Thus, the *Alderson* case is factually the precise converse of the instant case.* In *Alderson,* Alloy agreed, in essence, to act as a conduit through which title to the Salinas property ultimately would pass *to* taxpayers from the Salinas owners. In the instant case, viewing the facts in the light least favorable to petitioners, the Sharons agreed to act as conduits through which title to 571 Market Street ultimately

*See the diagram comparing the *Alderson* case with the instant case, at Appendix B hereof.

would pass *from* taxpayers to Standard Oil.* Furthermore, in *Alderson* taxpayers had a contractual obligation to *purchase* the Salinas property from the owners thereof, while in the instant case, taxpayers had a contractual obligation to *sell* 571 Market Street to Standard Oil.

This Court held that since taxpayers intended to effect an exchange, and since the net effect of the transaction was an exchange, taxpayers' position should be sustained, despite the fact that Alloy never acquired any "real" ownership of the Salinas property before it was transferred to taxpayers, and despite the fact that taxpayers had entered into a contract for the purchase for cash of that property.

Thus, the *Alderson* case provides the conclusive answer to the Tax Court's holding in the instant case that petitioners never effected an exchange of their property with the Sharons for the reason that the Sharons never obtained any ownership of that property. In *Alderson,* Alloy likewise never obtained any "real" ownership in the Salinas property, since Alloy, prior to the vesting of record title in its name, had agreed to the immediate reconveyance of that property to taxpayers. Nevertheless, this Court held that Alloy's lack of a "real" interest in the property transferred to taxpayers did not disqualify the transaction as an exchange:

> The title to the Lexington Street property was acquired by the Title Company for the purpose of the exchange, and it follows by analogy that *there was no need for Alloy to acquire a 'real' interest in the Salinas*

*Actually, petitioners' case is much stronger than taxpayers' position in *Alderson,* since petitioners executed the Agreement to Exchange and deposited deeds into escrow to the order of the Sharons before Standard Oil had exercised its option, precluding any finding that petitioners intended the Sharons would act as mere conduits through which 571 Market Street would pass.

property by assuming the benefits and burdens of ownership to make the exchange qualify under the statute although respondent asserts that failure of Alloy to hold a 'real' interest in the Salinas property precluded the transactions involved from being construed as constituting an exchange. (Emphasis added).

The Mercantile case appears to hold that one need not assume the benefits and burdens of ownership in property before exchanging it but may properly acquire title *solely for the purpose of exchange* and accept title and transfer it in exchange for other like property, all as a part of the same transaction with no resulting gain which is recognizable under Section 1002 of the Internal Revenue Code of 1954. (Emphasis added by court, 317 F.2d at p. 795).

There are, of course, two aspects to every exchange: The transfer of property *to* the taxpayer, and the transfer of property *from* him. Obviously, the courts must apply the same rules of law in determining the legal effect of both aspects of such transfers. *Alderson* holds that the party transferring property *to* the taxpayer need not have acquired any "real" interest in such property. It must follow, therefore, that the party receiving property *from* the taxpayer likewise need not acquire such an interest. Consequently, the fact that 571 Market Street passed simultaneously from the Sharons to Standard Oil did not disqualify the transaction as an exchange.

Furthermore, *Alderson* completely undermines the Tax Court's holding herein that Standard Oil's pre-existing contract to purchase petitioners' property for cash in some manner prevented petitioners from exchanging that property with the Sharons. In *Alderson,* taxpayers were likewise contractually obligated to purchase the Salinas property from its owner for cash. However, since the sole concern of the owner of that property was the receipt of

the purchase price in cash, and the form which the transaction took was of no consequence to him, this Court properly refused to hold that the existence of this contractual obligation of taxpayers was material in determining whether the substance of the transaction was an exchange. Similarly, since in the instant case Standard Oil's sole concern was to obtain a deed to 571 Market Street, and since it had no interest in or legal control over the form which this ultimate transfer took, the existence of this contractual obligation of petitioners likewise could not affect the substance of the transaction as an exchange.

The Tax Court attempted to distinguish the *Alderson* case, and other similar cases cited by petitioners, upon the purely factual ground that those cases involved the sufficiency of the transfer of property *to* the taxpayers, while the instant case involves the sufficiency of the transfer of property *from* the taxpayers. We have already pointed out that both aspects of an exchange must be governed by the same legal principles. The Tax Court utterly failed to apply the principles set forth in *Alderson* (and the other cases cited by petitioners) to the facts of the instant case, merely stating that "In each of those cases both the form and the substance of the transaction was an exchange." (C.T. 163). Petitioners submit that in the instant case, as we have shown, the transaction likewise took the form of an exchange, and that the substance of the transaction is identical to the *Alderson* case.

The principle announced in *Alderson* has been employed in numerous cases. See, *e.g., Coastal Terminals, Inc. v. United States,* 320 F.2d 333 (4th Cir. 1963); *Mercantile Trust Co.,* 32 B.T.A. 82 (1935), *acq.,* XIV-1 Cum. Bull. 13; *Antone Borchard,* 24 T.C. Memo. 1643 (1965). The following language from the *Mercantile Trust* case is particularly pertinent:

> In the cited case of *Gregory v. Helvering, supra* [293 U.S. 465], the Supreme Court determined the taxable status of the questioned transaction 'by what actually occurred'—the receipt of the taxed stock by the taxpayer. To sustain respondent upon the present record, we would be compelled to ignore the exchange that actually occurred, and tax, as received by the taxpayers, money never, in fact, received by or for them, in a sale that did not occur. We cannot here thus substitute fiction for fact. (32 B.T.A. at p. 87).

Similarly, in the instant case the Tax Court has ignored the exchange which actually occurred between petitioners and the Sharons, and has permitted a tax upon money never received by or for petitioners in a sale that never occurred. In *Mercantile Trust*, taxpayer had entered into alternative agreements with a title company, contemplating either the sale of their property or its exchange for like property in the event such property could be acquired. The court held that had taxpayers entered into separate agreements with the principals themselves, as did petitioners in the instant case:

> Clearly it could not be said that an actual exchange of petitioners' investment property with . . . [the exchanging party] was an actual sale of it to . . . [the ultimate purchaser], merely because petitioners exchanged rather than sold the property for the purpose of postponing or avoiding income taxes. (32 B.T.A. at p. 87).

This is precisely what happened in the instant case. While petitioners herein could have simply sold their property to Standard Oil, or (like the taxpayers in *Alderson, Coastal Terminals* and *Mercantile Trust*) could have arranged for Standard Oil to acquire the Sharon Building for purposes of exchanging it with petitioners, there was absolutely

nothing in fact or in law which prevented them from consummating an exchange of that property with the Sharons. The Tax Court's holding to the contrary is unsupported by law or fact and must be reversed.

C. Section 1031(a) Applies to Simultaneous Sales and Purchases Where an Exchange Was Intended by the Parties, and Where the Transaction Had the Net Effect of an Exchange

Petitioners have no serious quarrel with the Tax Court's premise that section 1031(a) was intended to apply only to a direct exchange, rather than to a sale and subsequent purchase, since as we have previously shown, petitioners in fact consummated such a direct exchange. The evidence is clear that both petitioners and the Sharons expressly intended to effect a direct exchange, the transactions in escrow took the form of a direct exchange, and the net effect of these transactions was that petitioners had consummated a direct exchange.

However, even if it were assumed that the instant situation took the form of a simultaneous sale and purchase, petitioners submit that the same tax consequences should follow, and that the Tax Court's limitation of section 1031 (a) to "direct exchanges" is unduly narrow, as many cases and authorities have pointed out.

Initially, the legislative history underlying section 1031 (a) amply supports the view that the rationale of that section applies to certain "indirect exchanges" cast in the form of simultaneous sales and purchases. The court in *Jordan Marsh Company v. Commissioner,* 269 F.2d 453, 455 (2d Cir. 1959), quotes from the pertinent committee reports as follows:

> 'In other words, profit or loss is recognized in the case of exchanges of notes or securities, which are essentially like money; or in the case of stock in trade;

> or in case the taxpayer exchanges the property comprising his original investment for a different kind of property; *but if the taxpayer's money is still tied up in the same kind of property as that in which it was originally invested, he is not allowed to compute and deduct his theoretical loss on the exchange, nor is he charged with a tax upon his theoretical profit. The calculation of the profit or loss is deferred until it is realized* in cash, marketable securities, or other property not of the same kind having a fair market value.' (Emphasis added).

Thus section 1031(a) was enacted to defer recognition of gain or loss in those situations where the taxpayer's money remains *tied up* in like property, preventing the use, control or enjoyment of the theoretical gain arising from the transaction. In the case of exchanges cast in the form of simultaneous sales and purchases in escrow, there is no use, control or enjoyment of the proceeds of the alleged sale, since the taxpayer has previously committed these proceeds for use in effecting the ultimate exchange.

The very cases upon which the Tax Court relied on this point support a broader interpretation of section 1031(a). Thus, in *Trenton Cotton Oil Co. v. Commissioner*, 147 F.2d 33, 36 (6th Cir. 1945), the court stated the underlying purpose of section 112(b) [now 1031(a)] to be as follows:

> The purpose of Section 112(b) was to save the taxpayer from an immediate recognition of gain and the tax thereon and conversely to intermit the claim of a loss in exchange transactions where gain or loss may have occurred in a constitutional sense, but where in a popular and economic sense there had been a mere change in the form of ownership or in other words that substance and not form should control in determining whether gain or loss had been realized or sustained. *Portland Oil Company v. Com'r*, 1 Cir., 109 F.2d 479.

It is no wonder, then, that more recent cases have adopted an approach including within the ambit of section 1031(a) certain transactions cast in the form of simultaneous sales and purchases which have the intended and actual effect of an ultimate exchange, without gain or loss in a popular and economic sense, and which result in a mere change in the form of ownership.

The Internal Revenue Service itself recognizes this principle. Rev.Rul. 57-469 (1957-2 Cum. Bull. 521) provides in pertinent part as follows:

> The courts have repeatedly held that where a sale is part of a transaction the purpose of which is to effectuate an exchange, and whereby an exchange has resulted, the transaction is an exchange for tax purposes and the sale is to be disregarded. [Citations] A fundamental principle of taxation is that substance and not form governs in tax matters. [Citations] In determining the substance of a transaction, the situation as it existed in the beginning and at the end of a series of steps and the object sought to be accomplished should be considered.

The most recent case adopting such an approach is *Coastal Terminals, Inc. v. United States,* 320 F.2d 333, 337 (4th Cir. 1963), also cited by the Tax Court as authority for restricting section 1031(a) to "direct exchanges." It is true that the court used these words in describing the type of transactions to which section 1031(a) applies. However, the court clearly indicated that transactions meeting the following tests would constitute "direct exchanges" qualifying under section 1031(a):

> *'Whether the transaction constituted a sale or an exchange for income tax purposes depends on the intent of the parties* and this intent is to be ascertained from all relevant facts and circumstances, and of neces-

sity the case is largely dependent upon circumstantial evidence.' (Emphasis added).

Sarkes Tarzian, Inc. v. United States (7th Cir.), 240 F.2d 467, 470.

'* * * *the transaction must be viewed as a whole, and each step, from the commencement of negotiations to the consummation of the sale, is relevant.*' (Emphasis added).

Commissioner of Internal Revenue v. Court Holding Co., 324 U.S. 331, 334, 65 S.Ct. 707, 708, 89 L.Ed. 981.

'The transaction here involved may not be separated into its component parts for tax purposes. *Tax consequences must depend on what actually was intended and accomplished rather than on the separate steps taken to reach the desired end.*' (Emphasis added).

Century Electric Co. v. Commissioner of Internal Revenue (8th Cir.), 192 F.2d 155, 159.

In accord are *Mercantile Trust Co. & Nelson v. Commissioner of Internal Revenue*, 32 B.T.A. 82; *W. D. Haden Co. v. Commissioner of Internal Revenue*, 165 F.2d (5th Cir.) 588, and *Alderson v. Commissioner of Internal Revenue* (9th Cir.), 317 F.2d 790.

Thus the test adopted by the court in *Coastal* and by the numerous cases cited therein, is simply this: Where the parties to a multi-step transaction *intended* to effect an exchange, and the *net effect* of such transaction was an exchange, the transaction will be treated as an exchange for tax purposes, regardless of the form of the separate steps taken to reach that end. Therefore, it is apparent that even if in form petitioners had "sold" their property to Standard Oil and, simultaneously, as part of the same multi-step transaction, "purchased" the Sharon property, the transaction would have met the tests of intent and net effect set forth above.

One is forced to the conclusion that in multi-party cases involving escrow transactions and common escrow agents,

the form or mechanics of the various transfers or the sequence of events in escrow are largely fortuitous, often subject to the arbitrary judgment of the common escrow holder and other factors over which the parties have little or no control, and as such should not override the intent of the parties and the net result obtained. *Given the decision to effect an exchange,* simultaneous transactions in escrow which have the net effect of an exchange should be so treated, regardless of the form which these transactions take.

For further cases and authorities recognizing these principles, see *J. H. Baird Publishing Co. v. C.I.R.,* 39 T.C. 608, 617-618 (1962), *acq.,* 1963-2 Cum. Bull. 4; *Allegheny County Auto Mart, Inc.,* 12 T.C. Memo. 427 (1953), *aff'd,* 208 F.2d 693 (3d Cir. 1954); *Century Electric Co. v. Commissioner,* 192 F.2d 155, 159-160 (8th Cir. 1951); *Louis W. Gumby, Inc. v. Helvering,* 122 F.2d 203, 205-206 (D.C. Cir. 1941); see also *Shoenberg v. Commissioner,* 77 F.2d 446, 449 (8th Cir. 1935), *cert. den.,* 296 U.S. 586 (1935); *Commissioner v. Dyer,* 74 F.2d 685 (2d Cir. 1935), *cert. den.,* 296 U.S. 586 (1935); *Frederick R. Horne,* 5 T.C. 250, 254-256 (1945); *Gregory v. Helvering,* 293 U.S. 465 (1935).

Each of these cases involved transactions which took the form of separate sales and purchases, but which were in substance and intent part of the same transaction, and therefore were treated as such for tax purposes. Therefore, while petitioners strongly contend that they effected a *direct* exchange with the Sharons, it is likewise clear from the foregoing authorities that even if the Tax Court were correct in holding that petitioners, prior to a sale of their property to Standard Oil, arranged for a simultaneous purchase of the Sharon Building with the intent to effect an ultimate exchange of like properties, the same tax consequences should follow.

V.

CONCLUSION

The evidence in this case is uncontradicted that petitioners and the Sharons intended to effect and did effect a direct exchange of 571 Market Street for the Sharon Building. The transaction between petitioners and the Sharons had every indicia of such an exchange, and the net effect from petitioners' standpoint was that such an exchange had been consummated.

On the other hand, the Tax Court's determination that petitioners sold their property to Standard Oil is contrary to fact and law. The fact that petitioners previously had granted to Standard Oil an option to purchase which, upon the exercise thereof, ultimately ripened into a contract of purchase and sale, did not, as a matter of law, prevent petitioners from consummating the exchange with the Sharons, who took 571 Market Street subject to Standard Oil's rights under said contract, and who thereupon reconveyed such property to Standard Oil in recognition of those rights. Furthermore, the transactions in escrow had none of the indicia of a sale from petitioners to Standard Oil. Petitioners never owned, used or enjoyed the monies placed into escrow by Standard Oil (which were distributed to the Sharons in accordance with the Sharons' instructions), and never authorized the escrow holder to convey 571 Market Street to Standard Oil. Petitioners' escrow instructions expressly provided for the transfer of 571 Market Street *to the Sharons,* while the Sharons' escrow instructions provided for the subsequent transfer of such property to Standard Oil *from the Sharons.* It is clear, therefore, that petitioners never sold 571 Market Street to Standard Oil.

However, even if the Tax Court were correct in determining that petitioners sold 571 Market Street to Standard Oil and purchased the Sharon Building from the Sharons with the proceeds of that sale, still the transaction should be treated as an exchange under section 1031(a). If a sale to Standard Oil in fact occurred, it was contrary to the express intent of both petitioners and the Sharons, it was consummated simultaneously with the transfer of the Sharon Building through a common escrow holder, and the net effect of the transaction was that an exchange in substance occurred. Petitioners realized no gain from the transaction in a popular or economic sense, and their money remained tied up in like investment property, satisfying the underlying aims of section 1031(a).

Petitioners respectfully submit that the decision of the Tax Court was incorrect and should be reversed.

Dated: March 31, 1966.

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CERTIFICATE OF COUNSEL

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

MICHAEL L. MELLOR

(Appendices Follow)

Appendix A

TABLE OF EXHIBITS

Exhibit No.	Description	Identified (references are to R.T. page nos.)	Received (references are to R.T. page nos.)	Printed (references are to C.T. page nos.)
1-A	Petitioners' 1958 tax return	7	62	28
2-B	Petitioners' 1959 tax return	7	62	49
3-C	Petitioners' 1960 tax return	7	62	62
4-D	Option agreement dated August 22, 1957	7	62	75
5-E	Letter dated August 29, 1957, from Buckbee Thorne to petitioners	7	62	77
6-F	Letter dated August 30, 1957 from Buckbee Thorne to Cal Pac	7	62	78
7-G	Letter dated November 25, 1957 from Cal Pac to Standard Oil	7	62	78
8-H	Written notice dated December 9, 1957 from petitioner John M. Rogers to Cal Pac	7	62	80
9-I	Cal Pac preliminary title report on the Sharon Building, dated December 9, 1957	7	62	82
10-J	Letter dated December 16, 1957 from Buckbee Thorne to Cal Pac.	7	62	84
11-K	Cal Pac receipt for check received from petitioner John M. Rogers, dated December 16, 1957	7	62	85
12-L	Deed to 571 Market Street dated December 17, 1957 delivered to Cal Pac by petitioners	7	62	86
13-M	Petitioners' escrow instructions to Cal Pac dated December 16, and 17, 1957	7	62	87
14-N	Standard Oil's escrow instructions to Cal Pac dated December 18, 1957	7	62	89
15-O	Letter dated December 19, 1957 from Cal Pac to Buckbee Thorne	7	62	97
16-P	Letter dated December 13, 1957 from Cal Pac to petitioners	7	62	98

Exhibit No.	Description	Identified (references are to R.T. page nos.)	Received (references are to R.T. page nos.)	Printed (references are to C.T. page nos.)
17-Q	Letter dated December 20, 1957 from Buckbee Thorne to petitioners	7	62	99
18-R	Letter dated December 23, 1957 from Buckbee Thorne to Cal Pac	7	62	100
19-S	Letter dated December 23, 1957 from Buckbee Thorne to petitioners	7	62	101
20-T	Deed to the Sharon Building dated December 19, 1957, executed by Hurford C. Sharon	7	62	102
21-U	The Sharons' escrow instructions to Cal Pac, dated January 16, 1958	7	62	104
22-V	Letter dated January 16, 1958 from Hurford C. Sharon to Cal Pac	7	62	109
23-W	The Sharons' supplemental instructions to Cal Pac, received by Cal Pac on January 16, 1958	7	62	111
24-X	Deed of Trust and Assignment of Rents delivered to Cal Pac by petitioners, dated January 15, 1958	7	62	112
25-Y	Cal Pac's receipt for Exhibit 24-X	7	62	118
26-Z	Pro-ration statement prepared by Buckbee Thorne and addressed to petitioners, dated January 16, 1958	7	62	119
27-AA	Pro-ration statement as in Exhibit 26-Z, dated same, addressed to Standard Oil	7	62	121
28-BB	Amendment to Exhibit 27-AA, same date	7	62	122
29-CC	Pro-ration statement prepared by Coldwell Banker & Co. and dated January 15, 1958	7	62	123
30-DD	Pro-ration statement dated January 17, 1958 prepared by Cal Pac	7	62	132
31-EE	Pro-ration statement dated January 17, 1958 prepared by Cal Pac	7	62	132-A

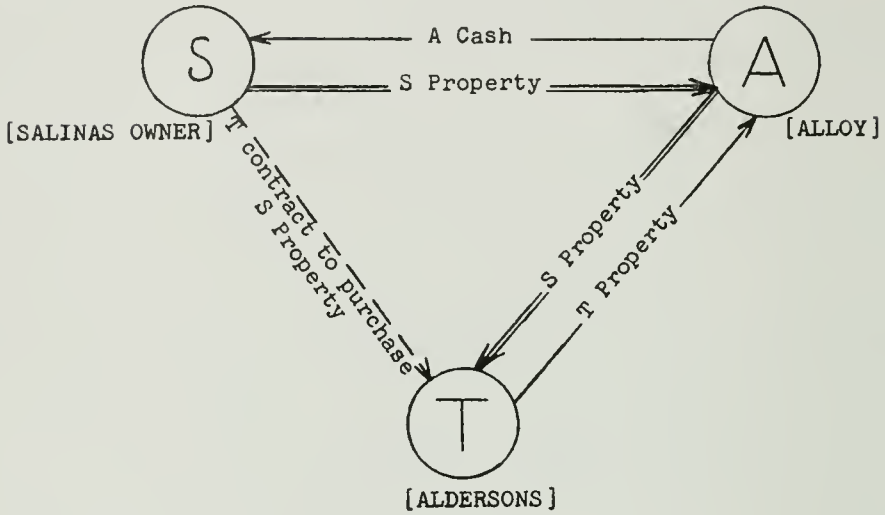
Exhibit No.	Description	Identified (references are to R.T. page nos.)	Received (references are to R.T. page nos.)	Printed (references are to C.T. page nos.)
32-FF	Letter dated January 14, 1958 from Buckbee Thorne to Coldwell Banker & Co.	7	62	133
33-GG	Letter dated January 16, 1958 from petitioners to American Trust Company	7	62	134
34-HH	Letter dated January 20, 1958 from Cal Pac to Standard Oil	7	62	135
35-II	Letter dated January 29, 1958 from Cal Pac to Coldwell Banker & Co.	7	62	138
36-JJ	Grant Deed to 571 Market Street from Cal Pac to Standard Oil, dated January 31, 1958	7	62	139
37-KK	Letter dated January 31, 1958 from Cal Pac to American Trust Company	7	62	140
38-LL	Cash flow schedule	7	62	141
39	Agreement to Exchange dated December 2, 1957	29	31	142

Appendix B

DIAGRAM OF THE

ALDERSON AND ROGERS CASES

I ALDERSON CASE (Alderson v. Commissioner, 317 F.2d 790 [9th Cir. 1963]):



II ROGERS CASE: